Is Silver Wheaton Corp. About to Rally?

Description

Silver Wheaton Corp. (TSX:SLW)(NYSE:SLW) is a favourite among investors who are bullish on gold and silver, but don't like the risks associated with owning mining companies.

Let's take a look at Silver Wheaton to see if it deserves to be in your portfolio.

Great margins

Gold and silver prices remain weak, but Silver Wheaton still earns impressive margins. The company's business model is structured in a way that Silver Wheaton doesn't actually dig the gold and silver out of the ground; it simply buys the product from miners at very low prices and sells it for a large profit.

Why would a miner give up so much margin?

Mining companies need a lot of money to build a mine or expand an existing one. When gold and silver prices are high, companies have an easy time of raising capital, either through share issues or by taking on debt. In the current environment, with prices of all the metals under pressure, finding money at a reasonable cost is very difficult.

Enter Silver Wheaton.

In exchange for supplying a miner with much-needed upfront capital, Silver Wheaton secures the right to purchase gold and silver by-product from the miner at very reasonable prices, often for the life of the mine.

Most of these deals are done for mines that primarily produce a base metal like copper, but also produce some silver and gold.

How good a deal does Silver Wheaton get?

In 2014 Silver Wheaton had an average silver equivalent cash cost of US$4.59. This is the combination of both its gold and silver supplies. The company's silver cost per ounce runs about US$4 per ounce and its gold costs are roughly US$400 per ounce.

Miners are looking at tight margins right now, but Silver Wheaton still enjoys a nice spread. In 2014 the company's average sale price for silver came in at US$18.92 per ounce and it received US$1,261 per ounce of gold.

Sliding stock price

Silver Wheaton's stock price tends to move with the precious metals markets, but company-specific events also have an impact. Management recently issued US$800 million in stock to pay for a new streaming deal with **Vale SA** that covers 25% of the gold output at Vale's Salobo copper mine. The market wasn't impressed and Silver Wheaton's shares fell below the bought deal price it agreed for the new stock. Underwriters took a hit and Silver Wheaton might have to offer a better discount the next time it tries to raise funds.

Should you buy?

The long-term fundamentals for the company look good. Silver Wheaton expects production to grow from 35.3 silver equivalent ounces in 2014 to 51 million ounces by 2019.

The shares are down 20% in the past three months and the stock has traded in a defined range for the past two years. Technical traders love the recent pattern and many are watching carefully right now, as the shares might be approaching another short-term bottom.

At the moment, the trend still looks negative and the stock could retest $20 before another upturn kicks in.

As you know, it's impossible to say when the stock will bounce, so you have to pick your price and run with it. The pattern for the past 24 months suggests that anything below $22 should be a decent entry point.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. TSX:WPM (Wheaton Precious Metals Corp.)

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